

Assembly Bill No. 1423

CHAPTER 490

An act to amend Sections 17088, 17145, 18155, 24427, 24870, 24871, and 24990.5 of, and to add Sections 17280.1, 17322.1, 24452.1, and 24871.1 to, the Revenue and Taxation Code, relating to taxation, and declaring the urgency thereof, to take effect immediately.

[Approved by Governor October 5, 2011. Filed with
Secretary of State October 6, 2011.]

LEGISLATIVE COUNSEL'S DIGEST

AB 1423, Perea. Income taxes: federal conformity: Regulated Investment Company Modernization Act of 2010.

The Personal Income Tax Law and the Corporation Tax Law, in modified conformity with federal income tax laws, provide for particular treatment of regulated investment companies, as specified, including particular treatment regarding capital loss carryovers, income and asset tests, dividend designation and allocation rules, the determination of earnings and profits, the passthrough of exempt-interest dividends and foreign tax credits, spillover dividends, return of capital distribution, distributions in redemption of stock, preferential dividends, deferral of late-year losses, holding period requirements, and sales load basis.

This bill would, under both laws, provide additional conformity with federal income tax laws by adopting specified provisions of the Regulated Investment Company Modernization Act of 2010 relating to regulated investment companies, as specified, including the imposition of a tax upon those companies that fail the above-mentioned asset test.

This bill would declare that it is to take effect immediately as an urgency statute.

The people of the State of California do enact as follows:

SECTION 1. Section 17088 of the Revenue and Taxation Code is amended to read:

17088. (a) (1) Subchapter M of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to regulated investment companies and real estate investment trusts, shall apply, except as otherwise provided.

(2) Part 1 of Subchapter M of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to regulated investment companies, as amended by the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(b) Section 17145 shall apply in lieu of Section 852(b)(5) of the Internal Revenue Code, relating to exempt-interest dividends.

(c) (1) Section 852(b)(3)(D) of the Internal Revenue Code, relating to treatment by shareholders of undistributed capital gains, shall not apply.

(2) Section 852(g)(1)(A) of the Internal Revenue Code is modified by substituting the phrase “subdivision (a) of Section 17145” for the phrase “the first sentence of subsection (b)(5)” contained therein.

(d) (1) Except as provided in paragraph (2), the amendments made to this section by the act adding this paragraph shall apply to taxable years beginning on or after December 23, 2010.

(2) (A) Section 851 of the Internal Revenue Code, relating to definition of regulated investment company, as amended by Section 201 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), and Section 852(b)(2)(G) of the Internal Revenue Code, as amended by Section 201 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply to taxable years with respect to which the due date (determined with regard to any extensions) of the return of tax for such taxable year is on or after December 23, 2010.

(B) Section 852(b)(4) of the Internal Revenue Code, relating to loss on sale or exchange of stock held six months or less, as amended by Section 309 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply to losses incurred on shares of stock for which the taxpayer’s holding period begins on or after December 23, 2010.

(C) Section 852(f)(1)(C) of the Internal Revenue Code, as amended by Section 502 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply to charges incurred in taxable years beginning on or after December 23, 2010.

(D) Section 855(a) of the Internal Revenue Code, relating to general rule, as amended by Section 304 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply to distributions in taxable years beginning on or after December 23, 2010.

SEC. 2. Section 17145 of the Revenue and Taxation Code is amended to read:

17145. (a) A regulated investment company, as defined in Section 851 of the Internal Revenue Code, relating to definition of regulated investment company, or series thereof, is qualified to pay exempt-interest dividends to its shareholders if, at the close of each quarter of its taxable year, at least 50 percent of the value of its total assets consists of obligations which, when held by an individual, the interest therefrom is exempt from taxation by this state.

(b) For purposes of this section:

(1) “Aggregate reported amount” means the aggregate amount of dividends reported by the company under paragraph (4) as exempt-interest dividends for the taxable year (including exempt-interest dividends paid after the close of the taxable year described in Section 855 of the Internal Revenue Code).

(2) “Excess reported amount” means the excess of the aggregate reported amount over the exempt interest of the company for the taxable year.

(3) “Exempt interest” means, with respect to any regulated investment company, the excess of the amount of interest received by it during its taxable year on obligations, interest on which, if held by an individual, is exempt from taxation by this state, over the amounts that, if it were treated as an individual, would be disallowed as deductions under Section 17280 of this part or Section 171(a)(2) of the Internal Revenue Code.

(4) (A) Except as provided in subparagraph (B), “exempt-interest dividend” means any dividend or part thereof (other than a capital gain dividend) paid by a regulated investment company or series thereof and reported by the company as an exempt-interest dividend in written statements furnished to its shareholders.

(B) If the aggregate reported amount with respect to the company for any taxable year exceeds the exempt interest of the company for such taxable year, an exempt-interest dividend is the excess of the reported exempt-interest dividend amount over the excess reported amount which is allocable to such reported exempt-interest dividend amount.

(C) (i) Except as provided in clause (ii), the excess reported amount (if any) which is allocable to the reported exempt-interest dividend amount is that portion of the excess reported amount which bears the same ratio to the excess reported amount as the reported exempt-interest dividend amount bears to the aggregate reported amount.

(ii) In the case of a taxable year which does not begin and end in the same calendar year, if the post-December reported amount equals or exceeds the excess reported amount for such taxable year, clause (i) shall be applied by substituting “post-December reported amount” for “aggregate reported amount” and no excess reported amount shall be allocated to any dividend paid on or before December 31 of such taxable year.

(5) “Post-December reported amount” means the aggregate reported amount determined by taking into account only dividends paid after December 31 of the taxable year.

(6) “Reported exempt-interest dividend amount” means the amount reported to its shareholders under paragraph (4) as an exempt-interest dividend.

(7) “Series” means a segregated portfolio of assets, the beneficial interest in which is owned by the holders of a class or series of stock of the regulated investment company that is preferred over all other classes or series with respect to that portfolio of assets.

(8) “Value” means, with respect to securities (other than those of majority-owned subsidiaries) for which market quotations are readily available, the market value of those securities; and with respect to other securities and assets, fair market value as determined in good faith by the board of directors or trustees, except that in the case of securities of majority-owned subsidiaries that are investment companies, as defined in the Investment Company Act of 1940, that fair value shall not exceed market value or asset value, whichever is higher.

(c) An exempt-interest dividend shall be treated by recipients thereof as an item of interest excludable from income.

(d) In the case of a qualified fund of funds, as defined in Section 852(g)(2) of the Internal Revenue Code, relating to fund of funds, that fund shall be qualified to pay tax-exempt dividends to its shareholders without regard to whether that fund satisfies the requirements of subdivision (a).

(e) The amendments made to this section by the act adding this subdivision shall apply to taxable years beginning on or after December 23, 2010.

SEC. 3. Section 17280.1 is added to the Revenue and Taxation Code, to read:

17280.1. (a) Section 267(f)(3) of the Internal Revenue Code, relating to loss deferral rules not to apply in certain cases, as amended by Section 306 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(b) This section shall apply to distributions on or after December 23, 2010.

SEC. 4. Section 17322.1 is added to the Revenue and Taxation Code, to read:

17322.1. (a) Section 302 of the Internal Revenue Code, relating to distributions in redemption of stock, as amended by Section 306 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(b) Section 316 of the Internal Revenue Code, relating to dividend defined, as amended by Section 305 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(c) (1) Subdivision (a) shall apply to distributions on or after December 23, 2010.

(2) Subdivision (b) shall apply to distributions made in taxable years beginning on or after December 23, 2010.

SEC. 5. Section 18155 of the Revenue and Taxation Code is amended to read:

18155. (a) A deduction shall not be allowed for capital loss carrybacks provided by Section 1212 of the Internal Revenue Code, relating to capital loss carrybacks and carryovers.

(b) Section 1212(a)(1)(C) of the Internal Revenue Code, as amended by Section 101 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(c) Section 1212(a)(3) of the Internal Revenue Code, relating to regulated investment companies, as amended by Section 101 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(d) Section 1222(10) of the Internal Revenue Code, relating to net capital loss, as amended by Section 101 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(e) (1) Except as provided in paragraph (2), the amendments made to this section by the act adding this paragraph shall apply to net capital losses for taxable years beginning on or after December 23, 2010.

(2) Section 1212(a)(3)(B) of the Internal Revenue Code, relating to coordination with general rule, as added by Section 101 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply to taxable years beginning on or after December 23, 2010.

SEC. 6. Section 24427 of the Revenue and Taxation Code is amended to read:

24427. (a) Section 267 of the Internal Revenue Code, relating to losses, expenses, and interest with respect to transactions between related taxpayers, shall apply, except as otherwise provided.

(b) Section 267(f)(3) of the Internal Revenue Code, relating to loss deferral rules not to apply in certain cases, as amended by Section 306 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(c) The amendments made to this section by the act adding this subdivision shall apply to distributions on or after December 23, 2010.

SEC. 7. Section 24452.1 is added to the Revenue and Taxation Code, to read:

24452.1. (a) Section 302 of the Internal Revenue Code, relating to distributions in redemption of stock, as amended by Section 306 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(b) Section 316 of the Internal Revenue Code, relating to dividend defined, as amended by Section 305 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(c) (1) Subdivision (a) shall apply to distributions on or after December 23, 2010.

(2) Subdivision (b) shall apply to distributions made in taxable years beginning on or after December 23, 2010.

SEC. 8. Section 24870 of the Revenue and Taxation Code is amended to read:

24870. (a) (1) Subchapter M of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to regulated investment companies and real estate investment trusts, shall apply, except as otherwise provided in this part.

(2) Part 1 of Subchapter M of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to regulated investment companies, as amended by the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(b) (1) Except as provided in paragraph (2), the amendments made to this section by the act adding this paragraph shall apply to taxable years beginning on or after December 23, 2010.

(2) (A) Section 851 of the Internal Revenue Code, relating to definition of regulated investment company, as amended by Section 201 of the Regulated Investment Company Modernization Act of 2010 (Public Law

111-325), and Section 852(b)(2)(G) of the Internal Revenue Code, as amended by Section 201 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply to taxable years with respect to which the due date (determined with regard to any extensions) of the return of tax for such taxable year is on or after December 23, 2010.

(B) Section 852(b)(4) of the Internal Revenue Code, relating to loss on sale or exchange of stock held six months or less, as amended by Section 309 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply to losses incurred on shares of stock for which the taxpayer's holding period begins on or after December 23, 2010.

(C) Section 852(f)(1)(C) of the Internal Revenue Code, as amended by Section 502 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply to charges incurred in taxable years beginning on or after December 23, 2010.

(D) Section 855(a) of the Internal Revenue Code, relating to general rule, as amended by Section 304 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply to distributions in taxable years beginning on or after December 23, 2010.

SEC. 9. Section 24871 of the Revenue and Taxation Code is amended to read:

24871. (a) (1) Section 852(b)(1) of the Internal Revenue Code, relating to imposition of tax on regulated investment companies, does not apply.

(2) Every regulated investment company shall be subject to the taxes imposed under Chapter 2 (commencing with Section 23101) and Chapter 3 (commencing with Section 23501), except that its "net income" shall be equal to its "investment company income," as defined in subdivision (b).

(3) (A) Section 851(d)(2)(C)(i)(I) of the Internal Revenue Code is modified by substituting "\$12,500" for "\$50,000."

(B) Section 851(d)(2)(C)(i)(II) of the Internal Revenue Code is modified by substituting the phrase "the rate of tax specified in Section 23151" for the phrase "the highest rate of tax specified in section 11" contained therein.

(C) Section 851(d)(2)(C)(iii) of the Internal Revenue Code, relating to administrative provisions, is modified by substituting the phrase "Article 3 of Part 10.2 (commencing with Section 19031), a tax imposed by this subparagraph shall be treated as a tax with respect to which the deficiency procedures of such article apply" for the phrase "subtitle F, a tax imposed by this subparagraph shall be treated as an excise tax with respect to which the deficiency procedures of such subtitle apply" contained therein.

(D) Section 851(i)(2) of the Internal Revenue Code, relating to imposition of tax on failures, shall not apply.

(b) "Investment company income" means investment company taxable income, as defined in Section 852(b)(2) of the Internal Revenue Code, modified as follows:

(1) Section 852(b)(2)(A) of the Internal Revenue Code, relating to an exclusion for net capital gain, does not apply.

(2) Section 852(b)(2)(B) of the Internal Revenue Code, relating to net operating losses, is modified to deny the deduction allowed under Sections 24416 and 24416.1, in lieu of denying the deduction allowed by Section 172 of the Internal Revenue Code.

(3) In lieu of the provision of Section 852(b)(2)(C) of the Internal Revenue Code, relating to special deductions for corporations, no deduction shall be allowed under Sections 24402, 24406, 24410, and 25106.

(4) (A) The deduction for dividends paid, under Section 852(b)(2)(D) of the Internal Revenue Code, is modified to allow capital gain dividends and exempt interest dividends (to the extent that interest is included in gross income under this part) to be included in the computation of the deduction.

(B) For purposes of this paragraph, Section 562(c) of the Internal Revenue Code, relating to preferential dividends, as amended by Section 307 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply.

(c) Section 852(b)(3)(A) of the Internal Revenue Code, relating to capital gains, does not apply.

(d) (1) Section 852(b)(5) of the Internal Revenue Code, relating to exempt-interest dividends, is modified by substituting the phrase “that, when held by an individual, the interest therefrom is exempt from taxation by this state” for the phrase “described in section 103(a)” contained therein.

(2) Section 852(b)(5)(A)(iv)(V) of the Internal Revenue Code, relating to exempt interest, is modified by substituting the phrase “on obligations that, if held by an individual, is exempt from taxation by this state, over the amounts disallowed as deductions under subdivision (b) of Section 24360 or Section 24425” for the phrase “excludable from gross income under section 103(a) over the amounts disallowed as deductions under sections 265 and 171(a)(2)” contained therein.

(3) Section 852(b)(5)(B) of the Internal Revenue Code, relating to treatment of exempt-interest dividends by shareholders, does not apply.

(e) Section 854 of the Internal Revenue Code, relating to limitations applicable to dividends received from regulated investment companies, is modified to refer to Sections 24402, 24406, 24410, and 25106, in lieu of Section 243 of the Internal Revenue Code.

(f) Section 852(g)(1)(A) of the Internal Revenue Code is modified by substituting the phrase “subdivision (a) of Section 17145” for the phrase “the first sentence of subsection (b)(5)” contained therein.

(g) (1) Except as provided in paragraphs (2) and (3), the amendments made to this section by the act adding this subdivision shall apply to taxable years with respect to which the due date (determined with regard to any extensions) of the return of tax for such taxable year is on or after December 23, 2010.

(2) Subparagraph (B) of paragraph (4) of subdivision (b) shall apply to distributions in taxable years beginning on or after December 23, 2010.

(3) Subdivision (f) shall apply to taxable years beginning on or after December 23, 2010.

SEC. 10. Section 24871.1 is added to the Revenue and Taxation Code, to read:

24871.1. (a) Section 860(f)(2)(B) of the Internal Revenue Code, as amended by Section 301 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(b) This section shall apply to taxable years beginning on or after December 23, 2010.

SEC. 11. Section 24990.5 of the Revenue and Taxation Code is amended to read:

24990.5. (a) Section 1201 of the Internal Revenue Code, relating to alternative tax for corporations, shall not be applicable.

(b) The provisions of Section 1212 of the Internal Revenue Code, relating to capital loss carrybacks and carryovers, as amended by Section 101 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(1) Section 1212(a)(1)(A) of the Internal Revenue Code, relating to capital loss carrybacks, shall not apply.

(2) Section 1212(a)(4) of the Internal Revenue Code, relating to special rules on carrybacks, shall not apply.

(3) Sections 1212(b) and 1212(c) of the Internal Revenue Code, relating to other taxpayers and carryback of losses from Section 1256 contracts to offset prior gains from such contracts, respectively, shall not apply.

(c) Section 1222(10) of the Internal Revenue Code, relating to net capital loss, as amended by Section 101 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply, except as otherwise provided.

(d) (1) Except as provided in paragraph (2), the amendments made to this section by the act adding this paragraph shall apply to net capital losses for taxable years beginning on or after December 23, 2010.

(2) Section 1212(a)(3)(B) of the Internal Revenue Code, relating to coordination with general rule, as added by Section 101 of the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), shall apply to taxable years beginning on or after December 23, 2010.

SEC. 12. This act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the Constitution and shall go into immediate effect. The facts constituting the necessity are:

Given the enactment of the federal Regulated Investment Company Modernization Act on December 22, 2010, which has already changed the tax rules pertaining to mutual funds and their shareholders for federal tax purposes, in order to avoid having two materially different federal and California tax rules governing the same investment and same income, and to eliminate uncertainty and confusion regarding the taxation of earnings and profits of Regulated Investment Companies and of the distributions to the some 6 million California shareholders, and thereby minimize

unnecessary and costly administrative burdens that adversely impact the Franchise Tax Board, it is necessary for this act to take effect immediately.

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